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Insurance Law—AN INSURER'S DUTY TO DEFEND ITS INSURED AND AN INSURER'S LIABILITY FOR WRONGFULLY DECLINING TO DEFEND ITS INSURED—*Lanoue v. Fireman's Fund American Insurance Cos.*, 278 N.W.2d 49 (Minn. 1979).

In recent years, courts have broadened an insurer's duty to defend its insured.¹ The once unchallenged² rule that only those allegations contained in an injured party's complaint will determine the insurer's duty to defend³ has been increasingly disregarded in favor of the rule that the facts surrounding a cause of action may also determine the insurer's duty to defend.⁴ Although an insurer's duty to defend arises from the insurance contract,⁵ courts have frequently overlooked the contractual terms giving the insured the right to a defense.⁶ Furthermore, courts often have ignored the distinction between an insurer's duty to defend and its

1. See R. KEETON, BASIC TEXT ON INSURANCE LAW §§ 6.3(a), 7.6(a) (1971). See generally Cahoon, *Company's Duty to Defend—Recent Developments*, 1961 INS. L.J. 151; Note, *Use of the Declaratory Judgment to Determine a Liability Insurer's Duty to Defend—Conflict of Interests*, 41 IND. L.J. 87 (1965); Note, *Determination of an Insurer's Duty to Defend*, 34 TEMP. L.Q. 152 (1961); Comment, *The Insurer's Duty to Defend Under a Liability Insurance Policy*, 114 U. PA. L. REV. 734 (1966).

2. It was not until 1937 that the apparently uniform acceptance of the general rule was broken. See Cahoon, *supra* note 1, at 151 & n.2.

3. *E.g.*, Truchinski v. Cashman, 257 N.W.2d 286, 287 (Minn. 1977); Republic Vanguard Ins. Co. v. Buehl, 295 Minn. 327, 332-33, 204 N.W.2d 426, 429 (1973). See generally 7C J. APPLEMAN, INSURANCE LAW & PRACTICE §§ 4682-4683 (Berdal rev. 1979); 14 G. COUCH, CYCLOPEDIA OF INSURANCE LAW §§ 51:40, :44 (2d ed. R. Anderson 1965 & Supp. 1978).

4. See, *e.g.*, Hartford Accident & Indem. Co. v. Civil Serv. Employees Ins. Co., 33 Cal. App. 3d 26, 34, 108 Cal. Rptr. 737, 742-43 (1973); Shepard Marine Constr. Co. v. Maryland Cas. Co., 73 Mich. App. 62, 65, 250 N.W.2d 541, 542 (1976); Crum v. Anchor Cas. Co., 264 Minn. 378, 392, 119 N.W.2d 703, 712 (1963); 14 G. COUCH, *supra* note 3, § 51:47.

5. An insurer's duty to defend its insured against suits seeking damages within policy coverage is a standard feature of liability insurance policies. See, *e.g.*, Republic Vanguard Ins. Co. v. Buehl, 295 Minn. 327, 332, 204 N.W.2d 426, 429 (1973) (insurer's duty to defend to be determined by allegations of complaint against insured and indemnity coverage afforded by policy); Iowa Nat'l Mut. Ins. Co. v. Universal Underwriters Ins. Co., 276 Minn. 362, 367, 150 N.W.2d 233, 236 (1967) (insurer's duty to defend is independent obligation existing exclusively between the insurer and the insured); 7C J. APPLEMAN, *supra* note 3, § 4682 (insurer has duty to defend any action when, if liability is established, the insurer would be liable); 14 G. COUCH, *supra* note 3, § 51:32 (insurer's duty to defend is correlative requirement to insurer's exclusive control over litigation against insured).

6. In Bituminous Cas. Corp. v. Bartlett, 307 Minn. 72, 240 N.W.2d 310 (1976), *overruled in part on other grounds*, Prahm v. Rupp Constr. Co., 277 N.W.2d 389, 391 (Minn. 1979), the provision that an insurer has a "duty to defend any suit against the insured seeking damages on account of . . . bodily injury or property damage [covered by this policy], even if any of the allegations of the suit are groundless, false or fraudulent," was construed to cover suits merely alleging a cause of action covered by the policy. See 307 Minn. at 75, 240 N.W.2d at 312. Such a construction disregards the apparent contractual

duty to pay claims covered by the policy.⁷ Related to the question of whether an insurer is obligated to defend is the question of which party, the insured or the insurer, has the burden of proving that the loss sustained falls within or without policy coverage.⁸

In *Lanoue v. Fireman's Fund American Insurance Cos.*,⁹ the Minnesota Supreme Court clarified its position on these issues. The court in *Lanoue* held that when the alleged cause of action is excluded from policy coverage but the insurer is aware of facts outside the complaint that may negate the exclusion, such facts must be considered in determining the insurer's duty to defend.¹⁰ The court also reaffirmed its position that an insurer seeking to avoid the obligation to defend its insured carries the burden of demonstrating that the cause of action falls clearly outside the scope of the policy coverage.¹¹ Finally, the *Lanoue* court held that insurers wrongfully refusing to defend actions against insureds must bear the insured's costs as well as the attorney's fees incurred by the insured in a declaratory judgment action.¹² *Lanoue* reinforces the Minnesota court's

intent that the insurer defend only those suits seeking recovery for injuries covered by the policy, regardless of the allegations in the injured party's complaint.

Likewise, in *Weis v. State Farm Mut. Auto. Ins. Co.*, 242 Minn. 141, 64 N.W.2d 366 (1954), the provision that the insurer agrees to "defend any suit against the insured alleging . . . injury [covered by this policy] and seeking damages on account thereof, even if such suit is groundless, false or fraudulent," was construed to relieve an insurer of its obligation to defend a suit alleging a cause of action within coverage when the insurer was aware that facts outside the complaint excluded the cause of action from coverage. *See id.* at 145, 64 N.W.2d at 368. Again, such construction disregards the insurer's apparent duty to defend any suit alleging a cause of action within policy coverage.

7. The phenomenon of courts ignoring the distinction is manifest in numerous decisions invoking the rules in complete disregard of the policy provisions establishing the insurer's duty to defend. *See, e.g.*, *Garden Sanctuary, Inc. v. Insurance Co. of N. America*, 292 So. 2d 75 (Fla. Dist. Ct. App. 1974) (insurer must defend against those portions of the complaint outside policy coverage but may decline to pay that portion of judgment outside policy coverage); *Shepard Marine Constr. Co. v. Maryland Cas. Co.*, 73 Mich. App. 62, 250 N.W.2d 541 (1976) (insurer required to look beyond third party's complaint to determine whether coverage was possible despite policy's exclusions); *Ohio Cas. Ins. Co. v. Flanagan*, 44 N.J. 504, 210 A.2d 221 (1965) (insurer required to defend despite several exclusions in policy).

8. *Cf. Boedigheimer v. Taylor*, 287 Minn. 323, 329, 178 N.W.2d 610, 614 (1970) (burden of proof rests on party claiming coverage, but once prima facie case for coverage is established, insurer has burden of proving applicability of any exclusions).

9. 278 N.W.2d 49 (Minn. 1979).

10. *Id.* at 53; *see Crum v. Anchor Cas. Co.*, 264 Minn. 378, 392, 119 N.W.2d 703, 712 (1963).

11. 278 N.W.2d at 53; *see Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389, 390 (Minn. 1979); *Bituminous Cas. Corp. v. Bartlett*, 307 Minn. 72, 76, 240 N.W.2d 310, 312 (1976), *overruled in part on other grounds*, *Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389, 391 (Minn. 1979).

12. 278 N.W.2d at 55; *see Morrison v. Swenson*, 274 Minn. 127, 138, 142 N.W.2d 640, 647 (1966).

now discernible position¹³ that it will carefully scrutinize insurance policy provisions that are contrary to an insured's reasonable expectations in order to effect a fair, if extra-contractual, construction of the insurance policy.¹⁴

The plaintiff in *Lanoue* was the owner and operator of a superette. A personal injury suit alleging a dram shop cause of action was brought against plaintiff individually and against his business.¹⁵ Plaintiff tendered defense of the suit to both his business liability insurer and his homeowner's insurer.¹⁶ Both insurers refused to assume the defense, asserting that they were not obligated to defend because the injured party's complaint alleged a cause of action excluded from the coverage of their respective policies.¹⁷ Plaintiff had informed each insurer of the facts surrounding the injury. These facts gave rise to a cause of action that ar-

13. Although the Minnesota court has regularly observed the general rule that the allegations in the complaint alone determine the insurer's duty to defend, *see* notes 34-35 *infra* and accompanying text, the court has demonstrated that it will ignore the general rule when the particular case before it requires that extraneous facts be considered. *See* note 38 *infra* and accompanying text.

14. *See* notes 29-33, 36-38 *infra* and accompanying text.

15. 278 N.W.2d at 51. The superette did not sell liquor but it did sell 3.2 beer. At about 11:00 p.m. on December 20, 1974, while the superette was still open for business, Daniel O'Brien, an off-duty minor employee at the superette, entered the store. O'Brien removed four six packs of 3.2 beer from the cooler and placed them outside the back door of the superette. He then broke into Lanoue's office and took a bottle of whiskey Lanoue had received as a Christmas gift from a wholesale supplier. After placing the whiskey outside the back door with the beer, O'Brien went back into the store and made several purchases. He then left the store through the front entrance and went around to the back where he recovered the beer and whiskey. Neither of the two employees then working in the store was aware of O'Brien's activity. Later that night another minor, Jeffrey Anderson, was injured in a one-car accident after having consumed some of the stolen whiskey. Nine months after the accident, Jeffrey Anderson's parents brought suit against Lanoue and his store alleging a dram shop cause of action. *See id.*

16. *Id.*

17. *Id.* Anderson's suit alleged that Lanoue, through his agents, servants, or employees, had furnished intoxicating beverages to Jeffrey Anderson. *Id.* Lanoue's business insurer, State Automobile & Casualty Underwriters, had expressly excluded indemnity for "bodily injury or property damage for which the insurer or his indemnitee may be held liable . . . as a personal organization engaged in the business of manufacturing, distributing, selling or serving alcoholic beverages." Respondent State Automobile and Casualty Underwriters' Brief at 4. Based upon the dram shop allegations in the complaint, the insurance company declined to defend Lanoue. 278 N.W.2d at 51.

Lanoue's homeowners policy, carried by Fireman's Fund American Insurance Companies, excluded indemnity for " 'bodily injury or property damage arising out of business pursuits of any insured except activities therein which are ordinarily incident to non-business pursuits [or for] bodily injury or property damage arising out of any premises, other than an insured premises, owned, rented or controlled by any insured.' " *Id.* at 53. Fireman's Fund maintained that the accident arose from business pursuits because the whiskey was given to Lanoue by a business associate and that the other-premises exclusion applied because the accident occurred away from the insured premises. *Id.* at 51.

guably constituted an "occurrence"¹⁸ within the insurance coverage.¹⁹ After the insurers had declined to defend the lawsuit, plaintiff retained counsel to defend the dram shop action and to seek declaratory judgment against the insurers.²⁰ In the declaratory judgment action, the trial court found that the insurance companies were not obligated to defend.²¹ Plaintiff appealed from this judgment.

The threshold question on appeal was whether the allegations in the original complaint controlled the insurer's obligation to defend.²² The long-established rule, still followed by a majority of courts, holds that the initial determination of an insurer's duty to defend depends solely on the allegations in the complaint.²³ The majority rule relieves an insurer of its duty to defend when the alleged cause of action is excluded from policy coverage,²⁴ even though facts outside the complaint may constitute an occurrence within the coverage of the policy and even though the allegations in the complaint may be wholly without basis.²⁵ Because

18. "Occurrence" is the comprehensive term used in liability insurance policies to describe the unexpected event or happening that the policy insures against. In *Bituminous Cas. Corp. v. Bartlett*, 307 Minn. 72, 240 N.W.2d 310 (1976), *overruled in part on other grounds*, *Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389, 391 (Minn. 1979), the policy in question defined an occurrence as "'an accident, including injurious exposure to conditions, which results, during the policy period, in bodily injury or property damage neither expected nor intended from the standpoint of the insured.'" 307 Minn. at 76, 240 N.W.2d at 312 (emphasis omitted).

19. Ambiguities as to the insurer's duty to defend are generally construed against the insurer. *Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389, 390 (Minn. 1979); *Lanoue v. Fireman's Fund Am. Ins. Cos.*, 278 N.W.2d at 53; *Bituminous Cas. Corp. v. Bartlett*, 307 Minn. 72, 76, 240 N.W.2d 310, 312 (1976), *overruled in part on other grounds*, *Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389, 391 (Minn. 1979); *Crum v. Anchor Cas. Co.*, 264 Minn. 378, 390, 119 N.W.2d 703, 711 (1963); 14 G. COUCH, *supra* note 3, § 51:45.

20. 278 N.W.2d at 51. Prior to the declaratory judgment action, Anderson amended the complaint to include a negligence cause of action. Both insurers agreed to defend the negligence cause of action. *Id.* at 51-52.

21. *Id.* at 52.

22. *Id.*

23. *See, e.g.*, *Lee v. Aetna Cas. & Sur. Co.*, 178 F.2d 750, 751 (2d Cir. 1949) (Hand, C.J.); *Republic Vanguard Ins. Co. v. Buehl*, 295 Minn. 327, 332, 204 N.W.2d 426, 429 (1973); Cahoon, *supra* note 1, at 153; Note, *Determination of an Insurer's Duty to Defend*, *supra* note 1, at 153; Comment, *supra* note 1, at 734-38.

24. *See, e.g.*, *Iowa Nat'l Mut. Ins. Co. v. Universal Underwriters Ins. Co.*, 276 Minn. 362, 369-70, 150 N.W.2d 233, 238 (1967) ("[W]here there is no coverage by reason of an exclusionary clause, there is no obligation of the insurer to defend."); *Bobich v. Oja*, 258 Minn. 287, 293, 104 N.W.2d 19, 24 (1960) ("[A]n insurer . . . is not bound to defend a suit on a claim outside the coverage of the policy, even though under the terms thereof it is obligated to defend all suits brought against the insured, whether groundless, false, or fraudulent.");

25. *See, e.g.*, *Lee v. Aetna Cas. & Sur. Co.*, 178 F.2d 750, 752-53 (2d Cir. 1949) (Hand, C.J.) ("[Where] the injured party [recovers] on a claim, which, as he had alleged it, was outside the policy; but which, as it turned out, the insurer was bound to pay . . . the insurer would not have to defend . . ."); 14 G. COUCH, *supra* note 3, § 51:41.

courts applying the general rule rely exclusively upon the allegations in the complaint, the rule may lead to harsh results.²⁶ The Minnesota

The *Lanoue* decision appears to be the result of the court's reluctance to subscribe to this particular consequence of the general rule; namely, that an insurer has no obligation to defend a suit alleging a cause of action excluded from coverage, even though facts outside the complaint bring the cause of action within coverage. In *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966), the California Supreme Court expressed its repugnance for the majority rule. The California court stated that a [d]efendant cannot construct a formal fortress of the third party's pleadings and retreat behind its walls. The pleadings are malleable, changeable and amendable. . . .

To restrict the defense obligation of the insurer to the precise language of the pleading would . . . create an anomaly for the insured. Obviously, . . . the complainant in the third party action drafts his complaint in the broadest terms; he may very well stretch the action which lies in only nonintentional conduct to the dramatic complaint that alleges intentional misconduct. In light of the likely overstatement of the complaint and of the plasticity of modern pleading, we should hardly designate the third party as the arbiter of the policy's coverage. *Id.* at 276, 419 P.2d at 176, 54 Cal. Rptr. at 112; *accord*, *Ritchie v. Anchor Cas. Co.*, 135 Cal. App. 2d 245, 251, 286 P.2d 1000, 1003-04 (1955).

26. Because the general rule requires an insurer to defend only those suits alleging a cause of action within policy coverage, *see, e.g.*, *Truchinski v. Cashman*, 257 N.W.2d 286, 287 (Minn. 1977) ("[w]here the allegations of a complaint state a cause of action within the terms of policy coverage, the insurance company must undertake to defend the insured") (quoting *Republic Vanguard Ins. Co. v. Byehl*, 295 Minn. 327, 332-33, 204 N.W.2d 426, 429 (1973)), regardless of the veracity of the allegations, *see, e.g.*, *Truchinski v. Cashman*, 257 N.W.2d at 287 ("[A]n insurer's obligation to defend does not depend upon the merits of the claim asserted against its insured."); *F.D. Chapman Constr. Co. v. Glens Falls Ins. Co.*, 297 Minn. 406, 408, 211 N.W.2d 871, 872 (1973) ("[Insurer] was required to defend all actions against the insured—however false or groundless—if the asserted cause of action was within the policy coverage."), *overruled in part on other grounds*, *Prahn v. Rupp Constr. Co.*, 277 N.W.2d 389, 391 (Minn. 1979), an insured can be left without defense provided by his insurer even though a duty to pay arguably exists. *See* notes 24-25 *supra* and accompanying text. The gap the general rule allows between the insurer's duty to defend and its duty to indemnify has prompted one commentator to suggest a third duty within the general rule, somewhere between the duty to defend and the duty to indemnify:

[I]t may be useful to distinguish between a duty to defend and a duty to prepare for defense—that is, a duty to take reasonable steps in preparation for defense against claims that may be asserted in the future. . . .

If a duty to prepare for defense is recognized, it might arise when no action has been filed and no claim has been made. It might also arise when an action has been filed (or a claim has been made) solely upon a basis that does not invoke a present duty to defend. The fact that the nature of the allegations (or claims) is not such as to invoke a duty to defend does not preclude the possibility that the nature of the underlying fact situation may give notice of a sufficient likelihood of later amendments, in which claims within coverage will be asserted, that the ordinarily prudent person would take immediate preparatory steps. It should be noted, however, that if this duty to prepare for defense is recognized, it does not arise because of the mere possibility that the injured party will later file a complaint, or an amended complaint, alleging a claim within policy coverage. That possibility could be said to exist in every case. The source of the duty is, instead, a probability of such degree that an ordinarily prudent person would act in advance to be prepared to meet it if it should arise.

Supreme Court, like courts in other jurisdictions,²⁷ has, on occasion, found it difficult to disregard facts outside the injured party's complaint.²⁸ For these reasons, the *Lanoue* court departed from the general rule, relying on *Weis v. State Farm Mutual Automobile Insurance Co.*²⁹ and

R. KEETON, *supra* note 1, § 7.6(a), at 474; see Comment, *Insurance—Insurer's Liability for Wrongful Refusal to Defend or Settle*, 36 U. MO. KAN. CITY L. REV. 304, 310 & n.30 (1968). Recognition of this duty might have been useful in *Lanoue*, although the majority and dissent undoubtedly would have differed on the likelihood of allegations within policy coverage being asserted.

27. See *Garden Sanctuary, Inc. v. Insurance Co. of N. America*, 292 So. 2d 75 (Fla. Dist. Ct. App. 1974); *Country Mut. Ins. Co. v. Murray*, 97 Ill. App. 2d 61, 239 N.E.2d 498 (1968); *Shepard Marine Constr. Co. v. Maryland Cas. Co.*, 73 Mich. App. 62, 250 N.W.2d 541 (1976); *Zurich Ins. Co. v. Rombough*, 19 Mich. App. 606, 173 N.W.2d 221 (1969); *Burd v. Sussex Mut. Ins. Co.*, 56 N.J. 383, 267 A.2d 7 (1970); *Cook v. Ohio Cas. Ins. Co.*, 418 S.W.2d 712 (Tex. Civ. App. 1967). But see *Ohio Cas. Ins. Co. v. Flanagan*, 44 N.J. 504, 210 A.2d 221 (1965); *Consolidated Underwriters v. Loyd W. Richardson Constr. Corp.*, 444 S.W.2d 781 (Tex. Civ. App. 1969).

28. See notes 29-38 *infra* and accompanying text. In *Iowa Nat'l Ins. Co. v. Universal Underwriters Ins. Co.*, 276 Minn. 362, 150 N.W.2d 233 (1967), the Minnesota Supreme Court noted that problems are likely to arise when liberal rules of pleading are coupled with a strict observance of the general rule. The court stated by way of dicta that:

an insurer may not safely assume that the limits of its duties to defend are fixed by the allegations a third party chooses to put in his complaint. While that rule would have appeal as an easy and convenient guide, it is not one to be relied upon under present practices where variances of proof from pleadings are generally tolerated and where relaxed pleading requirements under the Rules of Civil Procedure provide little assurance that the complaint of an injured party will reflect the full extent of his demands for relief.

Id. at 370, 150 N.W.2d at 238; see *Crum v. Anchor Cas. Co.*, 264 Minn. 378, 389, 119 N.W.2d 703, 710 (1963). But cf. Note, *Use of the Declaratory Judgment to Determine a Liability Insurer's Duty to Defend—Conflict of Interests*, 41 IND. L.J. 87 (1965). In this Note, the author espouses a strict distinction between an insurer's duty to indemnify and its duty to defend.

Although the insurer is not obligated to defend a claim outside the policy coverage, this does not necessarily mean that the insurer is relieved of all its obligations under the policy. If the insured [defends the suit and proves] the actual facts, the injured party's complaint would have [to be amended] to conform to the proofs; and any recovery then [would be] within the policy coverage.

Id. at 90; see 7C J. APPLEMAN, *supra* note 3, at § 4684. See generally MINN. R. CIV. P. 15. For a discussion of the flexibility of the modern rules of pleading, see 103 U. PA. L. REV. 445 (1954).

29. 242 Minn. 141, 64 N.W.2d 366 (1954). In *Weis* plaintiff-insured intentionally ran his car into a car owned by a third party. The third party and his wife took action to recover damages, alleging both negligent and intentional misconduct on the part of plaintiff. Upon receiving the third party's complaints, plaintiff notified his attorney who in turn notified defendant, plaintiff's automobile insurer. Defendant then sent its agent to visit plaintiff and discuss the matter. Plaintiff admitted to the agent that the collision was intentional and that there had been no accident. Defendant thereafter declined defense of the suit on the ground that no accident had occurred and that the entire incident resulted from plaintiff's deliberate actions. *Id.* at 142-43, 64 N.W.2d at 367.

Plaintiff successfully defended the suit brought by the third party. Plaintiff subsequently initiated an action to recover his defense costs from defendant, alleging wrongful refusal of defense. Although the third party's allegation of negligence was within policy coverage, the Minnesota Supreme Court looked past the allegations in the complaint to

*Crum v. Anchor Casualty Co.*³⁰ In *Weis* the court found an exception to the insurer's duty to defend when it held that an insurer had no duty to defend suits alleging a cause of action within policy coverage if facts outside the complaint exclude the cause of action from coverage.³¹ In *Crum* the court expanded the insurer's duty to defend by holding that the insurer must defend suits alleging a cause of action excluded from coverage when it has knowledge of facts outside the complaint which, if established, would bring the cause of action within coverage.³²

Despite the court's deviation from the general rule in *Weis*, *Crum*, and *Lanoue*,³³ the Minnesota court otherwise has held that only the allega-

plaintiff's conduct, statements, and admissions and held that the defendant's policy did not cover the deliberate and intentional wrongful acts of the plaintiff and that therefore defendant was not obligated to defend suits arising from those acts. *Id.* at 145-46, 64 N.W.2d at 368-69.

30. 264 Minn. 378, 119 N.W.2d 703 (1963). In *Crum* plaintiff-insured owned an apartment house that was insured by defendant's owners, landlords, and tenants liability policy. A tenant in plaintiff's building, who performed odd jobs around the apartment house for a reduction in rent, injured herself when she fell down a stairway while returning from a social visit with another tenant. The injured tenant sued plaintiff for negligently maintaining the premises. Plaintiff forwarded the tenant's complaint to defendant which undertook defense for the suit. *See id.* at 380-81, 119 N.W.2d at 704-05.

Although the tenant had unequivocally stated in her deposition that her injuries were sustained while on a personal errand and not while performing work for plaintiff, she later amended her complaint and alleged that her injuries arose out of and in the course of her employment. Defendant thereafter discontinued its defense of plaintiff stating that its policy expressly did not apply to injury to any employee of plaintiff arising out of and in the course of her employment. *See id.* at 381-83, 119 N.W.2d at 705-07.

Plaintiff's counsel continued defense of the suit and reached a settlement with the tenant. Plaintiff then sought to recover his defense and settlement costs from defendant, alleging wrongful refusal of defense. *See id.* at 384, 119 N.W.2d at 707. Appealing to facts outside the tenant's amended complaint, the Minnesota Supreme Court affirmed the trial court and held that because the insured has no control over the allegations of the complaint, when an insurer

is advised by the insured what he claims the facts to be or the insurer by an independent investigation ascertains that the facts are in conflict with the complaint and, if established, will present a potential liability on the part of the insured covered by the insurance contract, the insurer is obligated to undertake the defense.

Id. at 392, 119 N.W.2d at 712.

31. 242 Minn. 141, 144, 64 N.W.2d 366, 368 (1954).

32. 264 Minn. 378, 387-88, 119 N.W.2d 703, 709 (1963).

33. One week after its *Lanoue* decision, the court decided another case construing an insurer's duty to defend. In *Prahn v. Rupp Constr. Co.*, 277 N.W.2d 389 (Minn. 1979), the court held that when the cause of action against the insured does not fall clearly within the policy's exclusionary clause, the insurer is required to defend. *Id.* at 390. The court also overruled its prior position that an insurer may defend its insured while reserving the right to contest coverage. *Id.* at 391. The former position of the court is best illustrated in *Bituminous Cas. Corp. v. Bartlett*, 307 Minn. 72, 76, 240 N.W.2d 310, 312 (1976), *overruled in part on other grounds*, *Prahn v. Rupp Constr. Co.*, 277 N.W.2d 389, 391 (Minn. 1979), and *F.D. Chapman Constr. Co. v. Glens Falls Ins. Co.*, 297 Minn. 406, 408-09, 211 N.W.2d 871, 872 (1973), *overruled in part on other grounds*, *Prahn v. Rupp Constr. Co.*, 277

tions contained in an injured party's complaint may be considered when determining the insurer's duty to defend.³⁴ This divergent treatment of the insurer's duty to defend assumes continuity when viewed within the doctrine of reasonable expectations. This doctrine holds that an insured's reasonable expectations of coverage or benefits will be honored even though a strict reading of the insurance policy would deny such coverage.³⁵ Although the Minnesota court has never expressly adopted

N.W.2d 389, 391 (Minn. 1979). The *Prahn* court, recognizing the conflict of interest for the insurer in providing a defense under circumstances when it contests the validity of the coverage, held that the duty to defend after the insurer unsuccessfully contests coverage becomes a duty to reimburse the insured for reasonable attorney's fees incurred in defending the suit. See 277 N.W.2d at 391.

34. *Truchinski v. Cashman*, 257 N.W.2d 286 (Minn. 1977); *Red & White Airway Cab Co. v. Transit Cas. Co.*, 305 Minn. 353, 234 N.W.2d 580 (1975); *Republic Vanguard Ins. Co. v. Buehl*, 295 Minn. 327, 204 N.W.2d 426 (1973); *Bobich v. Oja*, 258 Minn. 287, 104 N.W.2d 19 (1960); see *Christian v. Royal Ins. Co.*, 185 Minn. 180, 240 N.W. 365 (1932).

35. A general statement of the doctrine is that "[t]he objectively reasonable expectations of [insurance] applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations." Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 967 (1970), reprinted in R. KEETON, *supra* note 1, at 351; accord, Gardner, *Reasonable Expectations: Evolution Completed or Revolution Begun?*, 1978 INS. L.J. 573, 576.

The doctrine of reasonable expectations has generally supplanted the "plain meaning" rule as the pervasive theory in insurance contract interpretation. The doctrine of reasonable expectations is broader than the long established rule that ambiguities in insurance contracts are to be construed against the drafter of the policy, see note 19 *supra*, because even though an insured's objectively reasonable expectations of his policy rights or coverage may be unambiguously limited or excluded by the policy, they will be honored. In an excellent comment on an insurer's duty to defend, the following hypothetical is given to demonstrate the practical utility of the reasonable expectations doctrine:

As to the insured's expectations, it is safe to assume that if the ordinary insurance consumer had thought about them, his expectations would be that the insurer would defend him whenever there was a threat of liability to him and the threat was based on facts within the policy. The insured probably would be surprised at the suggestion that defense coverage might turn on the pleading rules of the court that a third party chose or on how the third party's attorney decided to write the complaint. In some cases the insured might think in terms of his own conduct. The bar owner, for example, might well think that he is insulated from any legal expense arising from injuries to patrons so long as he personally does not intentionally injure someone or tell an employee to do so. To him the possibility of an ambitious claimant who would begin a lawsuit with a charge of intentional injury for the sake of a favorable bargaining position and later be willing to abandon that charge for one of simple negligence might not occur; or if the possibility did occur the insured might not pause to consider whether it would be fatal to part of his insurance coverage. In short, the limits of the phrase "suits alleging such injury," prepared by lawyers, defended by lawyers and authoritatively interpreted by lawyers, are probably not appreciated by the lay insured. And even the more sophisticated insured has no choice in the matter, since the provision is standard.

Comment, *supra* note 1, at 748 (footnote omitted).

the doctrine, ever since the decision of *Christian v. Royal Insurance Co.*,³⁶ the court generally has looked to the equities of the particular situation and has endeavored to honor the reasonable expectations of both insureds and insurers.³⁷ Only when faced with unusual fact situations has the

For an examination of the reasonable expectations doctrine, see *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); *Steven v. Fidelity & Cas. Co.*, 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 172 (1962); Gardner, *supra*, at 573; Kamarck, *Opening the Gate: The Steven Case and the Doctrine of Reasonable Expectations*, 29 HASTINGS L.J. 153 (1977); Knepper, *Insurer's Duty to Defend: Recent Developments*, 17 DEF. L.J. 391, 393-97 (1968); Perlet, *The Insurance Contract and the Doctrine of Reasonable Expectation*, 6 FORUM 116 (1971); Squires, *A Skeptical Look at the Doctrine of Reasonable Expectation*, 6 FORUM 252 (1971); Tobriner & Grodin, *The Individual and the Public Service Enterprise in the New Industrial State*, 55 CALIF. L. REV. 1247, 1273-76 (1967); Note, *The Insurer's Duty to Defend Made Absolute: Gray v. Zurich*, 14 U.C.L.A. L. REV. 1328 (1967); Note, *The Duty of an Insurer to Defend Its Insured*, 5 WILLAMETTE L.J. 321 (1969). The Lanoue court implied consideration of the doctrine by stating that if it denied that the insurers were initially obligated to defend, "insureds who buy insurance for the defense provided, not just for the indemnity features, would be losing part of the coverage they reasonably expected to have." 278 N.W.2d at 54; cf. *Weum v. Mutual Benefit Health & Accident Ass'n*, 237 Minn. 89, 105, 54 N.W.2d 20, 29 (1952) (in resolving ambiguities, the court avoids the interpretation that would forfeit rights the insured may have believed he was securing).

36. 185 Minn. 180, 240 N.W. 365 (1932).

37. See generally *Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389 (Minn. 1979) (insurer has duty to defend when the claim is not clearly outside the policy coverage); *Lanoue v. Fireman's Fund Am. Ins. Co.*, 278 N.W.2d 49 (Minn. 1979) (insurers required to defend when it cannot be shown that policy exclusions are applicable to all aspects of insured's claim); *Truchinski v. Cashman*, 257 N.W.2d 286 (Minn. 1977) (insurer has duty to defend when the allegations of the complaint against insured state a cause of action within policy coverage); *Farmers & Merchants State Bank v. St. Paul Fire & Marine Ins. Co.*, 309 Minn. 14, 242 N.W.2d 840 (1976) (insurer had no duty to defend insured bank when bank, through its officers, committed fraudulent acts that led to suit); *Bituminous Cas. Corp. v. Bartlett*, 307 Minn. 72, 240 N.W.2d 310 (1976) (masonry contractor's knowing violation of contract specifications would not reasonably be expected to be within general liability insurance policy coverage), *overruled in part on other grounds*, *Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389, 391 (Minn. 1979); *Red & White Airway Cab Co. v. Transit Cas. Co.*, 305 Minn. 353, 234 N.W.2d 580 (1975) (words of coverage for damages "caused by accident" in insurance policy not intended to include false arrests); *Republic Vanguard Ins. Co. v. Buehl*, 295 Minn. 327, 204 N.W.2d 426 (1973) (homeowners insurance policy held to include duty to defend parents against suit for negligent failure to supervise son riding motorcycle); *F.D. Chapman Constr. Co. v. Glens Falls Ins. Co.*, 297 Minn. 406, 211 N.W.2d 871 (1973) ("occurrence," within terms of insurance policy, held to include establishment of a nuisance), *overruled in part on other grounds*, *Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389, 391 (Minn. 1979); *Iowa Nat'l Mut. Ins. Co. v. Universal Underwriters Ins. Co.*, 276 Minn. 362, 150 N.W.2d 233 (1967) ("excess carrier" not entitled to reimbursement for expenses incurred in defending suit prior to time "primary carrier" took defense); *Lang v. General Ins. Co. of America*, 268 Minn. 36, 127 N.W.2d 541 (1964) (motor scooter held to be within motor vehicle exclusion in homeowners policy); *Crum v. Anchor Cas. Co.*, 264 Minn. 378, 119 N.W.2d 703 (1963) (insurer obligated to take defense when facts outside the complaint present potential liability on the part of the insured); *Bobich v. Oja*, 258 Minn. 287, 104 N.W.2d 19 (1960) (insurer not obligated to defend action based on use and ownership of automobile owned by corporate officer when policy only covered use of

court found it necessary to deviate from the general rule in order to preserve the coverage reasonably expected by the insured.³⁸ This approach indicates a willingness by the court to look beyond policy provisions to effect fair constructions of insurance contracts.

Chief Justice Sheran, joined by Justice Peterson, dissented from the majority opinion in *Lanoue*.³⁹ While the majority was willing to honor plaintiff's reasonable expectation of coverage, the dissent rigidly construed the coverage and exclusions of plaintiff's policies.⁴⁰ The dissenting

automobiles owned by the corporation); *Weis v. State Farm Mut. Auto. Ins. Co.*, 242 Minn. 141, 64 N.W.2d 366 (1954) (insurer not obligated to defend when injuries were caused by insured's own intentional acts and not by "accident" as stated in policy); *Christian v. Royal Ins. Co.*, 185 Minn. 180, 240 N.W. 365 (1932) (servant of insured killed by tractor being utilized to haul insured truck within coverage of policy insuring maintenance, ownership, and use of truck). Federal court decisions construing the insurer's duty to defend have generally paralleled the sentiment of the Minnesota court. *See generally* *Hagen Supply Corp. v. Iowa Nat'l Mut. Ins. Co.*, 331 F.2d 199 (8th Cir. 1964) (injuries to third person from discharge of tear gas device sold to minor through the mail by insured held not within insured's "Premises-Operations" liability coverage); *Globe Indem. Co. v. Hansen*, 231 F.2d 895 (8th Cir. 1956) (insurer not obligated to assume defense when insured is sued because of acts outside the policy coverage); *Kipka v. Chicago & N.W. Ry.*, 289 F. Supp. 750 (D. Minn. 1968) (insurer required to defend when third party complaint presents possible meritorious claim within coverage based on implied contractual indemnification obligation); *Government Employees Ins. Co. v. Swanson*, 246 F. Supp. 698 (D. Minn. 1965) (insurer seeking not to defend has burden of proving insured received notice of cancellation of policy); *Youghioghney & Ohio Coal Co. v. Employers' Liab. Assurance Corp.*, 114 F. Supp. 472 (D. Minn. 1953) (coverage upheld when hazard arose at the insured premises even though accident occurred away from the premises).

38. In the vast majority of cases, the general rule will undoubtedly protect the insured's objectively reasonable expectations of coverage. It is only the infrequent cases such as *Lanoue*, *Crum*, and *Weis*, in which known facts outside the injured party's complaint so utterly contradict the alleged cause of action and the insured's reasonable expectations, that courts are compelled to abandon the general rule.

In *Bituminous Cas. Corp. v. Bartlett*, 307 Minn. 72, 240 N.W.2d 310 (1976), *overruled in part on other grounds*, *Prahn v. Rupp Constr. Co.*, 277 N.W.2d 389, 391 (Minn. 1979), the Minnesota court recently summarized its position on an insurer's duty to defend when it stated that although the obligation to defend is contractual and is generally determined by the allegations of the complaint, the allegations do not control when facts outside the complaint establish the existence or nonexistence of an obligation to defend. 307 Minn. at 75, 240 N.W.2d at 312; *accord*, *Crum v. Anchor Cas. Co.*, 264 Minn. 378, 392, 119 N.W.2d 703, 712 (1963).

39. 278 N.W.2d at 55-56 (Sheran, C.J., dissenting).

40. *Id.* at 56 (Sheran, C.J., dissenting). The dissent could see no rationale for the majority's extension of the *Crum* holding from "defense required when facts known establish a cause of action covered by the policy" to "defense required when facts known indicate the exclusion doesn't apply." *Id.* (emphasis in original, footnote omitted). The dissent construed *Crum* to mean that if the facts outside an excluded cause of action establish a cause of action within coverage, the insurer is obligated to defend. *Id.* The point of departure between the majority and the dissent was whether or not the facts surrounding Jeffrey Anderson's accident were within policy coverage. The majority, acknowledging plaintiff's reasonable expectations and construing ambiguities against the insurers, *see Crum v. Anchor Cas. Co.*, 264 Minn. 378, 390, 119 N.W.2d 703, 711 (1963), had no

justices stated that they could not "disregard the language of insurance policies and . . . impose burdens on insurance companies for which they have in no way bargained."⁴¹ The dissent's respect for the "bargained" insurance contract is unusual. It is now widely recognized that insurance contracts are contracts of adhesion.⁴² Insurers' use of standardized form policies and the disparate bargaining strengths of insurers and insureds leave little room for bargained contracts.⁴³ By looking strictly to the injured party's complaint and by narrowly construing the coverage of the policies, the dissent would have denied plaintiff the right to be defended against a suit at least potentially within policy coverage.⁴⁴ The *Lanoue* majority chose to disregard the rule that the allegations exclusively determine the insurer's duty to defend. In finding that the insurers had a duty to defend, the majority acknowledged the principle that insureds purchase and expect protection from damages and lawsuits arising from occurrences arguably covered by their policies, not merely from allegations in complaints.

The court in *Lanoue* also decided that neither insurer had met its burden of proving that the claim fell outside its policy based on the exclu-

trouble finding coverage. 278 N.W.2d at 54. The dissent, on the other hand, was not nearly as sympathetic, stating that the facts "indicated neither a covered cause of action nor the likelihood of a covered suit." *Id.* at 56.

41. 278 N.W.2d at 55 (Sheran, C.J., dissenting). The dissent elaborated, explaining that

[n]ot only was the suit brought within exclusions to the two policies, but the actual facts known to the insurance companies established no cause of action within the coverage of either policy. . . .

To hold insurance companies responsible for the defense of an excluded suit under such circumstances is to ignore their right as businesses to provide only that product specified by the bargaining process.

42. In a case construing a liability insurance policy, the California Supreme Court described a contract of adhesion as "a contract entered into between two parties of unequal bargaining strength, expressed in the language of a standardized contract, written by the more powerful bargainer to meet its own needs, and offered to the weaker party on a 'take it or leave it basis.'" *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 269, 419 P.2d 168, 171, 54 Cal. Rptr. 104, 107 (1966).

The element of a negotiated or bartered exchange between traders is wholly absent in the creation of modern insurance contracts. *See Keeton, supra* note 35, at 966. The absence of a voluntary exchange and the inability of the weaker "bargainer" to improve his position is the essence of an adhesion contract.

[W]hen bargaining is absent, not only from the transaction but also from the process which produces the form, [there is still] a contract but, . . . it is a "contract of adhesion." One party "adheres" to the terms prescribed by the other. The adhering party consents but he lacks bargaining power to affect the terms to which he consents. The result is a private statute with the adhering party consenting to live under the "law" promulgated in the form.

Meyer, *Contracts of Adhesion and the Doctrine of Fundamental Breach*, 50 VA. L. REV. 1178, 1179 (1964). *See generally* Hollman, *Insurance as a Contract of Adhesion*, 1978 INS. L.J. 274; Note, *Insurance: The Meaning of the Contract in Light of the Insured's Reasonable Expectations*, 2 LINCOLN L. REV. 157 (1967).

43. *See* note 42 *supra*.

44. *See* notes 18-19 *supra* and accompanying text.

sions therein.⁴⁵ In placing the burden of proof on the insurer, the court relied on *F.D. Chapman Construction Co. v. Glens Falls Insurance Co.*,⁴⁶ which held that in order to negate the insurer's duty to defend, the pleadings and facts must clearly establish that the policy claim falls outside the policy terms.⁴⁷ With the burden placed on the insurer, the *Lanoue* court departed from the general rule that the burden of proof in a declaratory judgment action rests upon the complaining party⁴⁸ as well as the rule that the party claiming coverage under an insurance policy has the burden of proof.⁴⁹ In many instances, the Minnesota Supreme Court has placed the burden of proof on the insurer.⁵⁰ Prior to *Lanoue*, in a declaratory judgment action brought by an insurer, the court had stated that an insurer seeking to avoid having to defend carries the burden of demonstrating that the cause of action against the insured falls outside the scope of coverage.⁵¹ It is apparent from the holding in *Lanoue* that the rule

45. 278 N.W.2d at 53-54.

46. 297 Minn. 406, 211 N.W.2d 871 (1973), *overruled in part on other grounds*, Prahm v. Rupp Constr. Co., 277 N.W.2d 389, 391 (Minn. 1979); *accord*, Bituminous Cas. Corp. v. Bartlett, 307 Minn. 72, 75-76, 240 N.W.2d 310, 312 (1976), *overruled in part on other grounds*, Prahm v. Rupp Constr. Co., 277 N.W.2d 389, 391 (Minn. 1979); *cf.* Boedigheimer v. Taylor, 287 Minn. 323, 329, 178 N.W.2d 610, 614 (1970) (burden of proof shifts to insurer to prove exclusions apply after insured has established a prima facie case for coverage).

47. 297 Minn. at 408, 211 N.W.2d, at 872.

48. *See, e.g.*, Canadian Indem. Co. v. Ohio Farmers' Indem. Co., 251 F.2d 563, 570 (9th Cir. 1958); Standard Accident Ins. Co. v. Leslie, 55 F. Supp. 134, 136 (E.D. Ill. 1944); Reliance Life Ins. Co. v. Francher, 30 F. Supp. 264 (W.D. Mo. 1939); White v. Brookley Fed. Credit Union, 283 Ala. 597, 602-03, 219 So. 2d 849, 853 (1968) (*per curiam*).

49. *See* Boedigheimer v. Taylor, 287 Minn. 323, 329, 178 N.W.2d 610, 614 (1970) (burden of proof rests with party claiming coverage; once prima facie case for coverage is established, burden shifts to insurer to prove that any exclusions apply); *accord*, Cash v. Concordia Fire Ins. Co., 111 Minn. 162, 167, 126 N.W. 524, 525 (1910) (burden of proving insurable interest on insured, but issuance of policy is prima facie evidence thereof). *See also* National Aviation Underwriters, Inc. v. Fischer, 386 F.2d 582, 585 (8th Cir. 1967) (insurer asserting affirmative defense that insureds had falsely concealed nature of use of aircraft covered by policy had burden of proof).

50. *See, e.g.*, O'Connor v. Schwartz, 304 Minn. 155, 229 N.W.2d 511 (1975) (as to cause of damage to an automobile); Cavallero v. Travelers Ins. Co., 197 Minn. 417, 267 N.W. 370 (1936) (as to exclusion for wounds not visible); Harnischfeger Sales Corp. v. National Life Ins. Co., 195 Minn. 31, 261 N.W. 580 (1935) (as to fraudulent representations by insured in application for insurance); Topinka v. Minnesota Mut. Life Ins. Co., 189 Minn. 75, 248 N.W. 660 (1933) (nonpayment of insurance premiums); Thompson v. Bankers Mut. Cas. Ins. Co., 128 Minn. 474, 151 N.W. 180 (1915) (intoxication of insured at time of accident); Taylor v. Security Mut. Fire Ins. Co., 88 Minn. 231, 92 N.W. 952 (1903) (breach of condition against increased risks); Mistilski v. German Ins. Co., 64 Minn. 366, 67 N.W. 80 (1896) (breach of condition against incumbrances).

51. *See* Bituminous Cas. Corp. v. Bartlett, 307 Minn. 72, 76, 240 N.W.2d 310, 312 (1976), *overruled in part on other grounds*, Prahm v. Rupp Constr. Co., 277 N.W.2d 389, 391 (Minn. 1979). *See also* Government Employees Ins. Co. v. Swanson, 246 F. Supp. 698, 700 (D. Minn. 1965) (insurer bringing declaratory judgment action to determine duty to defend carries burden of proving that insured received notice of policy cancellation).

placing the burden of proof on the insurer will be applied regardless of which party initiates the declaratory judgment action. This holding is in accord with the accepted principle of resolving doubts concerning policy coverage in favor of the insured.⁵²

In addition to its holding regarding the duty to defend, the *Lanoue* court also examined the extent of an insurer's liability for wrongfully⁵³ declining defense. At the declaratory judgment trial, plaintiff sought to recover not only the judgment and costs incurred in defending the third party action but also the costs and attorney's fees he incurred during the declaratory judgment trial.⁵⁴ The court held that the insurers were liable for plaintiff's costs and attorney's fees incurred in the declaratory judgment action.⁵⁵ The court reasoned that the insurers' refusal of the tendered defense was a breach of the contractual duty to defend and that the costs of the declaratory judgment action as well as the costs of defending the third-party action were consequential damages of that breach.⁵⁶

Construing an insurer's wrongful refusal to defend as a breach of contract and awarding defense costs to the insured as consequential damages of the breach is the customary practice in cases similar to *Lanoue*.⁵⁷ The award of declaratory judgment costs, on the other hand, has not received

52. See, e.g., *Lees v. Smith*, 363 So. 2d 974, 979 (La. App. 1978) (insurer is obligated to provide defense unless plaintiff's petition unambiguously excludes coverage); *Bituminous Cas. Corp. v. Bartlett*, 307 Minn. 72, 76, 240 N.W.2d 310, 312 (1976) (insurer seeking to avoid duty to defend has burden of demonstrating that all aspects of cause of action against insured are outside scope of policy coverage), *overruled in part on other grounds*, *Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389, 391 (Minn. 1979); *Crum v. Anchor Cas. Co.*, 264 Minn. 378, 390, 119 N.W.2d 703, 711 (1963) (all doubts as to insurer's duty to defend should be resolved in favor of insured).

53. The words "erroneous," see *Rent-A-Scooter, Inc. v. Universal Underwriters Ins. Co.*, 285 Minn. 264, 268, 173 N.W.2d 9, 11 (1969), "unjustified," see 7C J. APPLEMAN, *supra* note 3, § 4690, and "unwarranted," see *id.* § 4691, have all been used to describe an insurer's refusal to defend a suit that it honestly believes is excluded from coverage but which later proves to be within coverage.

54. 278 N.W.2d at 51-52. There was a question as to whether the plaintiff had raised the issue of recovering his trial costs at the declaratory judgment trial. The court found that evidence on the issue was received at trial without objection and that plaintiff's counsel alluded to the issue in his final arguments and trial memorandum. *Id.* at 54. The court said that it was "apparent that plaintiffs intended to raise the issue and the failure of the defendants to respond to it will not preclude our considering it." *Id.*

55. *Id.* at 55.

56. *Id.*

57. See, e.g., *Hogan v. Midland Nat'l Ins. Co.*, 3 Cal. 3d 553, 476 P.2d 825, 91 Cal. Rptr. 153 (1970) (insured entitled to recover all attorney's fees incurred when insurer refused to defend despite fact that not all damages recovered by third party were within policy coverage); *Loeber Motors, Inc. v. Sims*, 34 Ill. App. 3d 342, 340 N.E.2d 132 (1975) (insurer liable for insured's attorney's fees when insurer wrongfully refused to defend covered claim); *American Mut. Liab. Ins. Co. v. Michigan Mut. Liab. Co.*, 64 Mich. App. 315, 235 N.W.2d 769 (1975) (same); *Abbey v. Farmers Ins. Exch.*, 281 Minn. 113, 160

widespread recognition.⁵⁸ The general rule is that attorney's fees are allowed only when authorized by statute or when provided for in the insurance contract.⁵⁹ The Minnesota Supreme Court has previously refused to award attorney's fees even when the insured was successful in the declaratory judgment action.⁶⁰ Other courts have refused to award attorney's fees incurred in declaratory judgment actions absent a showing of bad faith, fraud, or stubborn litigiousness on the part of the insurer.⁶¹

In deciding to award plaintiff his attorney's fees incurred in the declaratory judgment action, the court carefully pointed out that its decision

N.W.2d 709 (1968) (same); *Fruchtman v. State Farm Mut. Auto. Ins. Co.*, 274 Minn. 54, 142 N.W.2d 299 (1966) (same); *Christian v. Royal Ins. Co.*, 185 Minn. 180, 240 N.W. 365 (1932) (same); *Mannheimer Bros. v. Kansas Cas. & Sur. Co.*, 149 Minn. 482, 184 N.W. 189 (1921) (same); *Gordon v. Nationwide Mut. Ins. Co.*, 30 N.Y.2d 427, 295 N.E.2d 849, 334 N.Y.S.2d 601 (1972) (same).

58. Courts have generally denied insureds recovery of their declaratory judgment litigation costs if there has not been a showing of bad faith on the part of the insurer. *See, e.g.*, *Lowell v. Maryland Cas. Co.*, 65 Cal. 2d 298, 419 P.2d 180, 54 Cal. Rptr. 116 (1966) (insured not entitled to recover attorney's fees in his own action against insurer for breach of duty to defend); *Beck v. Pennsylvania Nat'l Mut. Ins. Co.*, 279 So. 2d 377 (Fla. Dist. Ct. App. 1973) (insured did not recover expenses of second suit when insured filed two separate suits against insurer for reimbursement instead of filing one suit after both third party actions had been decided); *Country Mut. Ins. Co. v. Murray*, 97 Ill. App. 2d 61, 239 N.E.2d 498 (1968) (insured denied recovery of attorney's fees for defending insurer's declaratory judgment action); *New Hampshire Ins. Co. v. Christy*, 200 N.W.2d 834 (Iowa 1972) (insurer not liable for insured's expense of defending declaratory judgment proceeding in absence of fraud or bad faith on part of insurer); *New Jersey Mfrs. Indem. Ins. Co. v. United States Cas. Co.*, 91 N.J. Super. 404, 220 A.2d 708 (App. Div. 1966) (same); *Johnson v. General Mut. Ins. Co.*, 24 N.Y.2d 42, 246 N.E.2d 713, 298 N.Y.S.2d 937 (1969) (insured entitled to damages for expenses in defending insurer's declaratory judgment action but not for expenses of prosecuting his cross claims against insurer).

59. 278 N.W.2d at 54; *Busse v. Board of County Comm'rs*, 308 Minn. 184, 190, 241 N.W.2d 794, 798 (1976); *State v. Carter*, 300 Minn. 495, 497, 221 N.W.2d 106, 107 (1974); *Abbey v. Farmers Ins. Exch.*, 281 Minn. 113, 115, 160 N.W.2d 709, 710 (1968); 16 G. COUCH, *supra* note 3, §§ 58:113-114 (2d ed. R. Anderson 1966 & Supp. 1979). *But see* MINN. STAT. § 555.10 (1978) (Minnesota Uniform Declaratory Judgments Act) ("[T]he court may make such award of costs as may seem equitable and just.").

60. *See Nelson v. American Reliable Ins. Co.*, 286 Minn. 21, 29, 174 N.W.2d 126, 131 (1970); *Rent-A-Scooter, Inc. v. Universal Underwriters Ins. Co.*, 285 Minn. 264, 268-69, 173 N.W.2d 9, 11-12 (1969); *Abbey v. Farmers Ins. Exch.*, 281 Minn. 113, 160 N.W.2d 709 (1968).

61. *See, e.g., Fidelity & Cas. Co. v. Riley*, 380 F.2d 153 (5th Cir. 1967) (insured not entitled to attorney's fees for defense of declaratory action brought by insurer in medical malpractice suit in absence of showing of bad faith in filing suit or that insurer was stubbornly litigious); *New Hampshire Ins. Co. v. Christy*, 200 N.W.2d 834, 843-44 (Iowa 1972) (explaining *Maryland Cas. Co. v. Sammons*, 63 Ga. App. 323, 326-27, 11 S.E.2d 89, 91-92 (1940) as refusing attorney's fees to insureds unless they show the insurer brought the declaratory judgment action in bad faith or was stubbornly litigious); *cf. Nationwide Ins. Co. v. Harvey*, 50 Ohio App. 2d 361, 363 N.E.2d 596 (1976) (insurer held accountable for insured's attorney's fees after insurer accepted defense and brought declaratory judgment action that appeared to the court to be intended to burden the insured by forcing defense of a needless action).

was within the limited exception to the general rule established in *Morrison v. Swenson*.⁶² In *Morrison* the court had held that an insurer that wrongfully refused to defend its insured will be held liable for "whatever expenses [the insured] has been compelled to incur in asserting his rights, as a direct loss incident to the breach of contract."⁶³ Although the Minnesota court had previously stated that more than an arguable difference of opinion between an insurer and its insured as to policy coverage would

62. 274 Minn. 127, 142 N.W.2d 640 (1966). In *Morrison* defendant insurance company refused to defend its insured against a suit arising from an automobile accident. The insured thought he was covered by the insurer's automobile liability policy when in fact the insurance agent, from whom the insured had purchased his policy, had failed properly to renew the policy. The agent was not employed by the insurer but sold insurance independently. The insurer refused defense of the third party injury suit on the theory that the policy covering the insured's car had lapsed and that the independent agent was the insured's broker, not its own agent. The Minnesota Supreme Court rejected this theory and determined that the agent was, from the standpoint of the insured, an agent of the insurer and that the insurer had allowed the agent to assume this appearance. *Id.* at 137, 142 N.W.2d at 646-47. The court therefore held that the insurer was responsible for the agent's actions and that it had wrongfully refused to defend. The court concluded its opinion by stating that the insurer was liable for the insured's declaratory judgment costs, even though there had been no showing of bad faith or unreasonable conduct on the part of the insurer. *Id.* at 138, 142 N.W.2d at 647.

63. *Id.* at 138, 142 N.W.2d at 647. Subsequent decisions have limited the breach of contract analysis to situations in which the insured had defended, or had been named to defend, a third party action prior to seeking declaratory judgment. *See Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389, 391 (Minn. 1979) (insured awarded declaratory judgment costs upon establishing insurer's duty to defend even though insured had not yet gone to trial against third party); *Nelson v. American Reliable Ins. Co.*, 286 Minn. 21, 24, 174 N.W.2d 126, 131 (1970) (declaratory judgment costs not awarded because there was no third party action); *Rent-A-Scooter, Inc. v. Universal Underwriters Ins. Co.*, 285 Minn. 264, 269, 173 N.W.2d 9, 11-12 (1969) (declaratory judgment costs not awarded because insured defaulted in third party action, thus incurring no defense costs); *Olsen v. Preferred Risk Mut. Ins. Co.*, 284 Minn. 498, 507-08, 170 N.W.2d 581, 587 (1969) (declaratory judgment costs not awarded where there are no third party litigation costs incurred); *Abbey v. Farmers Ins. Exch.*, 281 Minn. 113, 119, 160 N.W.2d 709, 712 (1968) (declaratory judgment costs not awarded when insured is seeking merely to recover benefits and has incurred no third party litigation costs). *But see Security Mut. Cas. Co. v. Luthi*, 303 Minn. 161, 171, 226 N.W.2d 878, 885 (1975) (insured who successfully established coverage was awarded declaratory judgment costs even though there was no third party action nor denial of defense by insurer).

In *Western Cas. & Sur. Co. v. Polar Panel Co.*, 457 F.2d 957 (8th Cir. 1972), the Eighth Circuit, applying Minnesota law, construed the denial of costs in *Rent-A-Scooter, Inc.* as overruling the *Morrison* rule. *Id.* at 961-62. Because the *Rent-A-Scooter, Inc.* court had denied declaratory judgment costs to an insured though it had successfully established the insurer's liability for a default judgment entered against it in a third party action, the federal court understood *Morrison* to be overruled and refused costs in a declaratory judgment action by an insured against its insurer who had refused to defend. The *Lanoue* court distinguished *Morrison* from *Rent-A-Scooter, Inc.* on the basis of relief requested. The *Lanoue* court noted that the insured in *Rent-A-Scooter, Inc.*, who had defaulted and therefore incurred no defense costs in the third party action, was seeking indemnity, not defense litigation costs, from its insurer and therefore the *Morrison* rule did not apply and no costs were to be awarded. 278 N.W.2d at 55 n.2.

be required to impose extra-contractual liability for legal fees on the insurer,⁶⁴ the *Lanoue* court distinguished declaratory judgment actions that determine only policy coverage from declaratory actions that determine the insurer's duty to defend or pay defense costs incurred by its insured.⁶⁵ The court said that when the duty to pay a claim is at issue, the general rule applies and declaratory judgment costs are awarded only if provided for by statute or by the insurance contract.⁶⁶ However, when the duty to defend is at issue and the insured succeeds in proving that the insurer has wrongfully refused the defense, recovery of declaratory judgment costs and attorney's fees is allowed.⁶⁷ Thus, regardless of who initiates the declaratory judgment action, whenever the insured establishes that the insurer is obligated to defend, the insured can recover the costs and attorney's fees incurred in the declaratory judgment action.⁶⁸

The *Lanoue* court recognized the distinction between an insurer's duty to defend and its duty to pay claims covered by the policy.⁶⁹ The court observed that "[t]he duty to defend is broader than the duty to indemnify."⁷⁰ The rationale that the court has repeatedly relied upon is that if courts do not hold insurers liable for the cost of a declaratory judgment action decided in the insured's favor, when there are ambiguities as to the obligation to defend, the insurer may be less inclined to accept tender of the defense or commence a declaratory judgment action to determine what its duty is under the circumstances.⁷¹ The court evidently fears that without adhering to its *Morrison* holding, insurers will idly refuse to defend all suits.

64. *Abbey v. Farmers Ins. Exch.*, 281 Minn. 113, 116-17, 160 N.W.2d 709, 711 (1968) (quoting *Sukup v. State*, 19 N.Y.2d 519, 522, 227 N.E.2d 842, 844, 281 N.Y.S.2d 28, 31 (1967)).

65. 278 N.W.2d at 54-55. In both cases, the declaratory judgment action determines the insurer's liability or probable liability under its policy; that is, the apparent coverage of the policy. Since insurance contracts obligate the insurer to defend all actions against the insured alleging facts covered by the policy, even though the allegations may be groundless, false, or fraudulent, *see* note 25 *supra* and accompanying text, the declaratory judgment action could well determine that an insurer has an obligation to defend a suit against its insured that proves to be excluded from coverage. Likewise, when an alleged cause of action is excluded from coverage and the facts of the action are not clearly within or without coverage, the trial court could declare that the insurer is required to defend its insured against a suit excluded from coverage. As the court stated in a footnote to the *Lanoue* decision: "The duty to defend is broader than the duty to indemnify." 278 N.W.2d at 53 n.1.

66. 278 N.W.2d at 54.

67. *Id.* at 55.

68. "[W]here an insurance contract is intended to relieve the insured of the financial burden of litigation, the insured will not be required to pay the litigation costs of forcing the insurer to assume that burden." *Id.* at 55.

69. *See id.* at 55.

70. 278 N.W.2d at 53 n.1.

71. The following excerpt from Mr. Appleman's treatise has been either quoted or cited in *Lanoue*, 278 N.W.2d at 55; *Nelson v. American Reliable Ins. Co.*, 286 Minn. 21, 29,

The *Lanoue* decision illustrates the Minnesota Supreme Court's concern for insureds who are unaware of the niceties of the insurance contract. The decision reveals the court's adherence to the principle that the insured's right to defense should not depend solely on the manner in which the injured party chooses to frame the complaint. Insurers in Minnesota must now look beyond an injured party's complaint when the alleged cause of action is excluded from coverage and facts known to the insurer contradict the allegations, potentially bringing the action within coverage. By recognizing an insurer's reasonable expectations of coverage and by charging insurers with the burden of disproving their duty to defend, no matter who initiates the declaratory judgment action, the court has compelled insurers to consider carefully their duty to defend.

While *Lanoue* favors the insured, the decision raises important questions regarding the procedure to be used when the insurer chooses to contest coverage. Most litigation over insurance coverage occurs in a declaratory judgment action determined prior to the merits of the main action against the insured. Findings that are part of the declaratory judgment, whether granting or denying the duty to defend or indemnify, may create a procedural impediment at the subsequent trial. While the former rule that coverage was determined on the basis of the allegations in the complaint made this possibility remote,⁷² *Lanoue's* requirement that facts outside the complaint be considered in determining coverage opens the door to factual determinations that may later constitute collateral estoppel. Thus, under *Lanoue*, the declaratory judgment action determining coverage may become as important as trial of the main action on the merits. Viewed in this light, *Lanoue* could seriously complicate the declaratory judgment procedure. Attorneys may now be required to use

174 N.W.2d 126, 131 (1970); *Rent-A-Scooter, Inc. v. Universal Underwriters Ins. Co.*, 285 Minn. 264, 268, 173 N.W.2d 9, 11 (1969); see *Morrison v. Swenson*, 274 Minn. 127, 138, 142 N.W.2d 640, 647 (1966):

Where an insurer failed to defend until after an adverse decision in a declaratory judgment action instituted by it, such insurer was held not liable to pay the attorneys' fees and expenses incurred by the insured in the declaratory judgment action, in the absence of fraud, bad faith, or stubborn litigiousness on the part of the insurer. But, despite the qualifications placed upon this rule by the court, it still appears to be unfair to the insured. After all, the insurer had contracted to defend the insured, and it failed to do so. It guessed wrong as to its duty, and should be compelled to bear the consequences thereof. If the rule laid down by these courts should be followed by other authorities, it would actually amount to permitting the insurer to do by indirection that which it could not do directly. That is, the insured has a contract right to have actions against him defended by the insurer, at its expense. If the insurer can force him into a declaratory judgment proceeding and, even though it loses such action, compel him to bear the expense of such litigation, the insured is actually no better off financially than if he had never had the contract right mentioned above.

7C J. APPLEMAN, *supra* note 3, § 4691 (footnote omitted).

72. See *Truchinski v. Cashman*, 257 N.W.2d 286 (Minn. 1977) (trial court judge may not give collateral estoppel effect to finding in declaratory judgment action erroneously based on facts beyond allegations in complaint).

extreme care in the presentation of factual issues in declaratory judgment proceedings in which coverage cannot be determined solely upon the allegations of the complaint.

Torts—MUNICIPAL TORT LIABILITY—*Kossak v. Stalling*, 277 N.W.2d 30 (Minn. 1979).

The Minnesota Municipal Tort Liability Act¹ imposes significant restrictions on the ability of victims of municipal² negligence to seek redress for injuries. The most important of these restrictions are the requirements that the plaintiff serve timely notice of a possible tort claim upon the municipality, and that the action be commenced, in most cases, within one year of the notice.³ In an effort partially to alleviate the inequities inherent in these requirements, the Minnesota Supreme Court has recently abandoned the rule of strict compliance with the notice of claim

1. MINN. STAT. §§ 466.01-.15 (1978 & Supp. 1979).

2. MINN. STAT. § 466.01(1) (1978) defines "municipality" as "any city, whether organized under home rule charter or otherwise, any county, town, public authority, public corporation, special district, school district, however organized, county agricultural society organized pursuant to chapter 38, or other political subdivision." *Id.*

3. *See* Act of May 22, 1963, ch. 798, § 5, 1963 Minn. Laws 1396, 1398, which was in effect on the date of the accident in *Kossak*. It provided:

Every person who claims damages from any municipality for or on account of any loss or injury within the scope of Section 2 shall cause to be presented to the governing body of the municipality within 30 days after the alleged loss or injury a written notice stating the time, place and circumstances thereof, and the amount of compensation or other relief demanded. Failure to state the amount of compensation or other relief demanded does not invalidate the notice; but in such case, the claimant shall furnish full information regarding the nature and extent of the injuries and damages within 15 days after demand by the municipality. No action therefor shall be maintained unless such notice has been given and unless the action is commenced within one year after such notice. The time for giving such notice does not include the time, not exceeding 90 days, during which the person injured is incapacitated by the injury from giving the notice.

Id. MINN. STAT. § 466.05(1) (1978) presently provides:

Except as provided in subdivisions 2 and 3, every person who claims damages from any municipality for or on account of any loss or injury within the scope of section 466.02 shall cause to be presented to the governing body of the municipality within 180 days after the alleged loss or injury is discovered a notice stating the time, place and circumstances thereof, and the amount of compensation or other relief demanded. Actual notice of sufficient facts to reasonably put the governing body of the municipality or its insurer on notice of a possible claim shall be construed to comply with the notice requirements of this section. Failure to state the amount of compensation or other relief demanded does not invalidate the notice; but in such case, the claimant shall furnish full information regarding the nature and extent of the injuries and damages within 15 days after demand by the municipality. No action therefore shall be maintained unless such notice has been given and unless the action is commenced within one year after such notice. The time for giving such notice does not include the time, not exceeding 90 days, during which the person injured is incapacitated by the injury from giving the notice.

Id. No notice is required for injuries from intentional torts or the use of motor vehicles owned by a municipality or operated by its employees. *Id.* § 466.05.